Engine Capital Issues Letter to the Board of Directors of Avantax Regarding the Urgent Need to Explore Strategic Alternatives

Outlines 10 Reasons Why Engine Believes Now is the Right Time for Avantax to Publicly Commit to a Formal Strategic Alternatives Process to Maximize Value for All Stockholders

Asserts a Sale Can Unlock Between $27 and $32 Per Share, or a ~34% Premium for Stockholders, Based on Recent Wealth Management Transactions

NEW YORK—(BUSINESS WIRE)—Engine Capital LP, which owns approximately 2% of the outstanding shares of Avantax, Inc. (NASDAQ: AVTA) ("Avantax" or the "Company"), today announced that it has sent the below letter to the Company's Board of Directors (the "Board").

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June 5, 2023

Avantax, Inc.
3200 Olympus Boulevard, Suite 100
Dallas, TX 75019
Attention: Board of Directors

Dear Members of the Board:

Engine Capital LP (together with its affiliates, "Engine" or "we") is a significant stockholder of Avantax, Inc. (NASDAQ: AVTA) ("Avantax" or the "Company"), with an ownership position of approximately 2% of the Company's outstanding common shares. We want to first commend you for completing the TaxAct divestiture and returning the proceeds of that sale to stockholders through a Dutch tender offer and regular share buybacks.

Despite these efforts and recent business momentum, Avantax's stock continues to trade at a meaningful discount to its strategic value. We believe this is primarily due to the fact that Avantax is a subscale asset in the consolidating asset management industry where size is increasingly important. **That is why we encourage the Board to initiate and publicly commit to a review of strategic alternatives – including a sale of the entire Company – which we believe could fetch between $27 and $32 per share, or a 34% premium for stockholders**.[1]

We are aware of the discussions management and the Board have had with several parties over the last year regarding a potential sale of Avantax. Unfortunately, none of these discussions were in the context of a formal process so these potential buyers were not compelled to put their best offer forward or felt the sense of urgency that a competitive auction would create. Below, we detail the 10 reasons why Engine firmly believes *now* is the right time for Avantax to publicly announce a sale process.

1. Avantax is a subscale asset in a consolidating industry where size matters

Avantax derives its profit from two different sources – the services it renders to its financial advisors and the cash sweep. The Company has limited control over the profit coming from the cash sweep as well as the profit sharing with its financial advisors. Therefore, when benchmarking Avantax's margins to its peers, we believe it is important to isolate the revenue and profit from the service side of the business, excluding

[1] Applying 13x and 15x EBITDA multiples to Engine's estimate of normalized EBITDA for the Company, we believe that Avantax could be sold today between $27 and $32 per share, which is a respectable 34% premium to the Company's current share price at the midpoint of the range.

the cash sweep as well as the payments to its financial advisors. We, therefore, define margin as Adjusted EBITDA excluding cash sweep / Gross Profit excluding cash sweep.

As the table below indicates, Avantax is barely profitable at a ~2% margin in 2022, while LPL Financial Holding Inc.'s (NASDAQ: LPLA) ("LPL") margin is ~26%. Of course, it would not be fair to take 2022 numbers for Avantax given the expenses associated with TaxAct's transition service agreement and other temporary costs it is currently incurring. But even if we assume that Avantax is able to cut its overhead by 33% (~$10 million), its margin structure would still be completely out of sync with LPL (~8% vs ~26%).

	LPL	AVTA	
	2022A	**2022A**	**($10M Cost Cut)**
Revenue	$8,600.8	$666.5	$666.5
Less: Cash Sweep	(953.6)	(49.8)	(49.8)
Revenue Excluding Cash Sweep	**$7,647.2**	**$616.7**	**$616.7**
Gross Profit	$3,189.9	$221.6	$221.6
Less: Cash Sweep	(953.6)	(49.8)	(49.8)
Gross Profit Excluding Cash Sweep	**$2,236.3**	**$171.8**	**$171.8**
As % Revenue Excluding Cash Sweep	29.2%	27.9%	27.9%
Adj. EBITDA	$1,525.3	$53.7	$63.7
Less: Cash Sweep	(953.6)	(49.8)	(49.8)
Adj. EBITDA Excluding Cash Sweep	**$571.7**	**$3.9**	**$13.9**
As % Revenue Excluding Cash Sweep	*7.5%*	*0.6%*	*2.2%*
As % of Gross Profit Excluding Cash Sweep	**25.6%**	**2.3%**	**8.1%**

Source: AVTA and LPL company filings and Engine analysis.

Avantax is simply subscale and cannot compete on equal footing with larger firms. Since size matters in the asset management space, Avantax is worth considerably more to a large consolidator than as a standalone entity.

2. **Avantax is unlikely to optimize its cost structure as a standalone entity, given its historic holding company structure**

While we expect Avantax to continue reducing its cost structure, in practice, we are skeptical the Company can effectively optimize costs in the public market given its historic holding company structure. For example, there is no reason for CEO Chris Walters, who has little relevant industry experience, to be running an asset management firm and overseeing Avantax's President Todd Mackay. Optimally, the Avantax CEO would have the relevant industry experience to oversee the operations of Avantax and run the public entity. But we are skeptical the Board will ever correct this duplicity, despite its leading to a few million dollars of unnecessary leakage, which is relatively significant considering Avantax's core business will only generate ~$10 million in Adjusted EBITDA in 2022.[2] There are several other examples of similar duplications across the organization today, which further contribute to Avantax's low margins versus peers. These inefficiencies would be easily eliminated in a sale, further contributing to the difference between Avantax's strategic value versus its standalone value.

3. **Avantax's competitive positioning is deteriorating**

The gap between the value proposition offered by Avantax and its larger peers is widening, putting the Company's competitive advantages increasingly at risk. We question how long Avantax can remain relevant when large competitors are able to dwarf the Company's investments in technology, product development

[2] Engine estimate based off management's 2023 EBITDA guidance.

and customer service. As an example, LPL spent ~$270 million in technology in 2022 alone, has spent more than $900 million in technology since 2018 and is spending north of $1.3 billion in G&A primarily to better service its advisors and accelerate organic growth. Avantax is behind the curve when it comes to technological capabilities compared to its larger peers, putting the Company at a significant disadvantage in terms of recruiting new advisors and retaining existing ones. Practically, we do not believe that time is on Avantax's side.

4. **Avantax's current structure as a standalone business is putting pressure on profitability**

Given these headwinds and market dynamics, Avantax will be forced to increasingly invest in the business to try to keep up with its larger peers. As a result, the Company's profitability is likely to remain subpar. This is currently hidden by the significant cash sweep revenue. As the cash sweep revenue normalizes, Avantax will be left with a difficult choice. It will either have to prioritize profitability, reduce its investments in the business and put itself in an even worse competitive position or it will continue investing and highlight its poor profitability. We view both options as losing propositions for stockholders in the long term.

5. **Avantax's recent business momentum makes a sale more timely**

Despite its worsening competitive positioning, some of Avantax's metrics have incrementally improved and the business is experiencing positive momentum – namely improvements in recruitment, retention, advisor experience and positive net flows, as well as a positive shift in mix toward advisory assets. The Board should take advantage of this positive momentum to sell the business in the near term, and not convince itself that these positive results are sustainable or a validation of Avantax's positioning. The reality is that despite these incremental improvements, Avantax lags its peers and will continue to struggle to grow organically given its scale.

6. **Absent a sale, we believe the standalone value of the business is lower than where the stock trades today – implying downside**

To assess the standalone value of Avantax, we need to calculate a normalized level of EBITDA. If we assume that the Fed Funds rate normalizes at ~2.5% that implies ~$65 million of EBITDA contribution from the cash sweep. If we generously assume the core business is able to reach a 15% margin (vs. 2.3% in 2022), the core business would contribute another $25 million in EBITDA, for a total of $90 million in EBITDA. Using LPL's historical multiple, we can calculate a range of standalone value for Avantax between $16 and $21 per share, implying no upside from current prices.

Normalized EBITDA	$90.0	$90.0	$90.0
EV/ EBITDA Multiple	*8.0x*	*9.0x*	*10.0x*
Enterprise Value	**$720.0**	**$810.0**	**$900.0**
Less: Net Debt	(94.6)	(94.6)	(94.6)
Plus: FCF 2023E	50.0	50.0	50.0
Equity Value	**$675.4**	**$765.4**	**$855.4**
Shares Outstanding	*41.3*	*41.3*	*41.3*
Implied Share Price	**$16.37**	**$18.55**	**$20.73**
Upside (Downside) to Current ($22.01)	*(25.6%)*	*(15.7%)*	*(5.8%)*

7. **Avantax's stock has traded down to a price where a transaction is eminently doable given relevant merger premiums**

Given the benefits of scale in the asset management space and Avantax's own inefficiencies, it is obvious that the value of Avantax to a large consolidator is vastly superior to its standalone value. We have listed several relevant precedent transactions in *Appendix A*, which point to transaction multiples between 13x and 18x EBITDA. We believe a transaction for Avantax would take place between 13x and 15x EBITDA. **Applying these multiples to our estimate of normalized EBITDA, we believe that Avantax could be sold today between $27 and $32 per share, which is a respectable 34% premium to the Company's current share price at the midpoint of the range**.

Normalized EBITDA	$90.0	$90.0	$90.0
Transaction Multiple	*13.0x*	*14.0x*	*15.0x*
Enterprise Value	**$1,170.0**	**$1,260.0**	**$1,350.0**
Less: Net Debt	(94.6)	(94.6)	(94.6)
Plus: FCF 2023E	50.0	50.0	50.0
Equity Value	**$1,125.4**	**$1,215.4**	**$1,305.4**
Shares Outstanding	*41.3*	*41.3*	*41.3*
Implied Deal Price	**$27.28**	**$29.46**	**$31.64**
Upside (Downside) to Current ($22.01)	*23.9%*	*33.8%*	*43.8%*

8. **While hedging interest rates may make sense, it should only be done after the Company has run a formal sale process**

On the Company's Q1 2023 earnings call, management mentioned that it is exploring the possibility of hedging interest rates in relation to its cash sweep program. We believe such a hedge should only be put in place after the Board has explored a sale and decided to keep the Company independent because this hedge is likely to reduce the price a buyer may be willing to pay. Strategic buyers may or may not want to hedge and if they do, they can do it cheaper than Avantax can, given their scale. A hedge would also lower the Company's EBITDA, which a buyer would use to reduce its price.

We would also note that the time to hedge was a few months ago when investors had an expectation that Fed Funds rates would stay high for a while. Today, the market expects Fed Funds rates to go down dramatically making the hedge less interesting and more costly.

9. **A public process is more likely to yield strong results given the Company's recent history with interested buyers**

Even though management has had discussions with several interested parties, we believe there is a fair amount of skepticism as to whether management and the Board are truly willing to transact. As an example, we understand the Company ran a limited process in October 2021. That process, which was specifically for the entire Company only, was described by two of the involved parties as a "sham process that was designed to fail." We believe a public announcement of the process would signal a different level of commitment and would motivate buyers to give this process their full attention.

10. **The Board should not anchor to the recent $30 per share tender price**

While we hope a sale process will result in a price above $30 per share, it may not. And we do not believe the Board should regard $30 per share as a threshold just because it recently completed the tender at that price. The world has significantly changed since then: banks have collapsed, and the prospect of a recession has risen. The expected normalized Fed Funds rate has come down, impacting Avantax's normalized profitability. The Board did the right thing by repurchasing the stock at $30 per share, which was the clearing price of the tender at the time. Given the changing market dynamics, it is imperative that the Board chooses the path that de-risks and unlocks value for stockholders. We do not believe any of our fellow stockholders would fault the Board if a sale took place below $30 per share.

In conclusion, we believe now is the right time for the Board to publicly announce a robust strategic process to maximize value for stockholders. We request a meeting with members of the Board at your earliest convenience to discuss the matters set forth in this letter. On behalf of Engine, we look forward to working cooperatively with you to increase long-term stockholder value.

Very truly yours,

Arnaud Ajdler
Managing Partner

Appendix A: Relevant Wealth Management Precedent Transactions			
Date	Buyer	Target	EV/ LTM EBITDA
January-20	Blucora	HKFS	*17.8x*
November-19	Advisor Group	Ladenburg Thalmann	*12.8x*
March-19	Blucora	1st Global	*18.0x*
October-15	Blucora	HD Vest	*14.5x*
January-14	RCS Capital	J.P. Turner & Company	*13.8x*
January-14	RCS Capital	Cetera Financial Group	*16.8x*
June-13	RCAP Holdings	First Allied Holdings Inc.	*13.1x*
Median			***14.5x***
Average			***15.3x***

Notes:

(1) Purchase prices include earn-outs where applicable, LTM EBITDA excludes synergies

(2) Data per publicly available filings and company materials

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About Engine Capital

Engine Capital is a value-oriented special situations fund that invests both actively and passively in companies undergoing change.

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